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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

May 31, 1996

Mr. Andrew Mulitz
Common Carrier Bureau
Accounting and Audits Division
Federal Communications Commission
2000 L Street, NW
Room 257
Washington, DC 20554

DOCKET FILE COPY ORIGINAL

Re: CC Docket No. 96-112
Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services

Dear Mr. Mulitz:

As required by the Notice of Proposed Rulemaking in the above-captioned proceeding, GTE is submitting a diskette of GTE's Comments and one hard copy of the Comments.

Sincerely,

Gail Polivy

Gail L. Polivy

Enclosures

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MAY 3 1996

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C.

In the Matter of	)	
	)	
Allocation of Costs Associated with	)	CC Docket No. 96-112
Local Exchange Carrier Provision of	)	
Video Programming Services	)	

GTE's COMMENTS

GTE Service Corporation on behalf of GTE's domestic telephone and wireless service companies

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May 31, 1996

THEIR ATTORNEY

SUMMARY

1. GTE urges the Commission to put aside the cost allocation proposals of the *Notice* as unnecessary and contrary to the thrust of the Telecommunications Act of 1996.

2. The cost allocation proposals of the *Notice* could deter LEC provision of advanced telecommunications services employing integrated facilities.

3. Price caps and competition make unnecessary the heavy-handed reliance on Part 64 methods reflected in the *Notice*.

4. Rather than introducing arbitrary fixed factors, the Commission should simply adopt guidelines concerning allocation of regulated and nonregulated costs -- to be taken into account in the CAM process as each firm determines appropriate accounting treatment based on its own individual conditions

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GTE's COMMENTS

GTE Service Corporation and its affiliated domestic telephone, wireless and video companies ("GTE"), with regard to the Notice of Proposed Rulemaking (the "NPRM" or "*Notice*"), FCC No. 96-214 (released May 10, 1996), that concerns implementation of the Telecommunications Act of 1996 (the "1996 Act"), offers the following comments.

I. THE COST ALLOCATION PROPOSALS SET FORTH IN THE *NOTICE* ARE UNNECESSARY AND INCONSISTENT WITH THE DEREGULATORY THRUST OF THE 1996 ACT.

Congress clearly intended for the Commission to implement the 1996 Act so that it would encourage Local Exchange Carriers ("LECs" or "exchange carriers") to pursue various options for entry into local video markets, encourage investment in new technologies, and expand the availability of choices of video programming services to subscribers.[1] The Act also encourages LECs to enter and compete in other markets from which they have been historically excluded.[2] Thus, the 1996 Act adopts a

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[1] *See* 47 U.S.C. Section 571 *et seq.* All statutory section references are to 47 U.S.C. unless otherwise specified.

[2] See Section 253(a).

deregulatory and pro-competitive policy -- one that calls for new and alternative regulatory approaches to reflect the rapid growth of competition in telecommunications markets.

Rather than attempting to craft a more accommodating regulatory framework, the proposals set forth in the *Notice* generally rely on antiquated approaches that would make the FCC's cost allocation rules even more arbitrary and burdensome. Given incentive (price cap) regulation, these rules are far less useful and significant than they were when framed in 1987. Rather than reexamining these rules in the spirit of the 1996 Act -- in order to reduce the burdens to match reductions in the need for regulation -- the *Notice* proposes massive increases in regulatory burdens together with the imposition of admittedly arbitrary allocators that would distort the economics of both the LECs' regulated business and of unregulated affiliate enterprises employing common facilities. Indeed, the proposals of the Notice would not only continue the mechanisms of monopoly-based regulation even as LECs operate in competitive markets; they would significantly increase the burden of detailed regulation. In GTE's view, Section 254(k) need not, and should not entail an expansion of the scope and depth of the FCC's cost allocation rules.

GTE suggests the Commission can fulfill the mandate of Section 254(k) through employment of its existing price cap mechanisms and cost allocation rules (which should be modified by replacing the forward-looking allocator) , for the existing rules were created to cover this very eventuality -- common usage of the same facilities by regulated and unregulated affiliate enterprises Events that have occurred since adoption of the cost allocation rules -- principally passage of the 1996 Act and implementation of price caps -- dictate reduced, not increased, regulation.

In summary: GTE urges the Commission to put aside the cost allocation proposals of the Notice as unnecessary and contrary to the thrust of the 1996 Act.

II. THE COST ALLOCATION PROPOSALS SET FORTH IN THE *NOTICE* COULD DISCOURAGE LEC PROVISION OF ADVANCED TELECOMMUNICATIONS SERVICES VIA INTEGRATED FACILITIES.

Federal policies should be designed to encourage efficient delivery of new telecommunications services over integrated facilities by all market participants. As the Commission recognizes, significant economic and efficiency gains can be realized through LEC provision of video and telephone services over single integrated networks. However, if the Commission adopts many of the proposals set forth in the *Notice* -- such as exchange by exchange allocations and creation of additional cost pools -- exchange carrier costs of providing new and competitive video services to subscribers could be needlessly inflated, rendering them incapable of pricing services on a competitive basis.

Imposition of many of the cost allocation proposals set forth in the *Notice*, such as requiring a fixed portion of a LEC's network to be allocated to nonregulated activities regardless of the demand for such services, would place LECs at an unfair economic and competitive disadvantage. This is reinforced by the FCC's evident plans for implementation of the cable television reform provisions of the 1996 Act which, among other things, would liberalize the effective competition test applicable to cable television systems subject to rate regulation.[3] This could mean incumbent cable operators would be freed from all rate regulation, including the requirement that rates be uniform throughout a franchise area, once a LEC begins to provide video services to subscribers in the franchise area. Further, once the modified local competition provisions of the Act are put in place, cable companies will seek to provide local telephone services to customers within their service territories. In effect, then, an unaffiliated cable operator would be free from all rate and cost regulation for both cable and telephone service, while LECs operating video distribution systems would continue to face a myriad of price controls and expanded cost allocation requirements. The proposals of the *Notice* appear to follow a self-contradictory logic: increasing regulatory requirements as, with competition, the need for regulation decreases.

As the Notice acknowledges (at paragraphs 37-42), the rules it tentatively adopts would intentionally allocate more cost to nonregulated operations than can be shown to be justified. This is not at all like the decision approved by the courts in 1988,[4] which was simply carrying out decisions made by the FCC on joint board recommendation under the very broad authority of Section 410. Here, the arbitrary imposition of an allocator does not follow from a Section 410 decision; it would have to stand on its own feet as a fair estimation. Moreover, while such an action may have served the public interest in a monopoly environment, it will have the opposite effect in an increasingly

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3 Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996,, CC Docket No. 96-85, Order and Notice of Proposed Rulemeaking, FCC 96-154 (released April 9, 1996), at paragraphs 6-7 *et seq.*

4 Rural Telephone Coalition v. FCC, 838 F.2d 1307, 1312-13 (D.C. Cir. 1988), cited by the NPRM at n.51.

competitive environment. Action imposing onerous cost allocation and accounting rules in an increasingly competitive market would significantly increase the risk for LECs seeking to engage in the development of new services and service delivery mechanisms. Indeed, the end result would be a significant disincentive for exchange carriers to explore alternative video distribution methods, such as Open Video Systems (OVS), through the integration of such offerings with telephone and other LEC services, and would be in direct opposition to the thrust of the 1996 Act.

In summary: The cost allocations proposals of the Notice could deter LEC provision of advanced telecommunications services employing integrated facilities.

III. UNDER PRICE CAP REGULATION, CONTINUED RELIANCE ON PART 64 METHODS IS NO LONGER WARRANTED.

As LEC markets become increasingly competitive and regulated services become subject to price cap or other incentive plans, continued reliance on Part 64 rules is simply unnecessary. The Commission's price cap plan for LEC access services effectively prevents LECs from making wholesale rate increases for regulated services to fund development of its nonregulated operations. Indeed, GTE has announced plans to invest substantial sums in the development of its video business. At the same time, GTE's access rates under price caps have remained stable or have declined in recent years. And to the extent that exchange carriers select the highest productivity factor under price caps, they are no longer subject to any sharing obligation -- which eliminates the link between service prices and allocated costs.[5]

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[5] "In their most recent annual tariff filings, however, all but four incumbent local exchange carriers subject to our price cap rules elected the highest interim productivity factor we had prescribed, which exempt them from sharing

Further, many state utility commissions in states in which GTE operates have adopted alternative regulatory incentive plans that have effectively frozen or similarly restricted movement in local and intrastate service rates. These plans effectively prevent exchange carriers from reflecting costs associated with providing nonregulated services in regulated service prices. There is no need for still more "protection."

Regulated and nonregulated services should each bear the costs for the exchange carrier to furnish them with service. Cost allocation methods that attempt to allocate costs on a cost-causative basis are most likely to produce more efficient and economic pricing for both classes of service. On the other hand, arbitrary allocations -- such as those based on a fixed factor -- will tend to produce rate levels that send uneconomic pricing signals to the market, not only for those nonregulated services in purely competitive markets, but also for those regulated services that are now, or soon will be, subject to heightened competition.

In summary: Price caps and competition make unnecessary the heavy-handed reliance on Part 64 methods reflected in the *Notice*.

IV. INSTEAD OF RELYING ON ARBITRARY FIXED FACTORS, THE COMMISSION SHOULD ADOPT ONLY GENERAL GUIDELINES FOR PURPOSES OF ALLOCATING REGULATED AND NONREGULATED COSTS.

GTE generally agrees with goals set forth in the *Notice* that cost allocation methods imposed on LECs should be administratively simple, adaptable to evolving technologies, and adhere in general to the principle of cost causation. In fact, GTE believes that many aspects of the existing Part 64 rules overly complicate the allocation

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obligations for the 1995-1996 access year." NPRM at paragraph 61, *footnotes omitted*.

of costs associated with new and advanced telecommunications services (*e.g.*, the forward-looking allocator based on three-year forecasts). On the other hand, the adoption of a single fixed allocation factor applicable to all service delivery architectures, in all areas, irrespective of market conditions and demand, would present risks that would discourage LECs from investing in more efficient integrated facilities -- a high price to pay for administrative simplicity. The obvious danger in the adoption of a fixed allocator -- which would essentially amount to a "rule of thumb" -- is it will burden the competitive services demanded by customers with unjustified cost allocations -- an outcome that will reduce LECs' ability to compete with entrenched cable firms. GTE urges the Commission to take a more reasonable approach.

A. Allocation of loop plant should be based on guidelines rather than a single fixed allocator.

The *Notice* tentatively concludes that local loop plant should be allocated based on a fixed allocation factor without identifying how such an allocator would be determined or applied.[6]

Adoption of a single fixed allocator to be used in all instances would be inherently arbitrary and would only perpetuate the infirmities of traditional monopoly regulation. In order for such a factor to reflect properly the mix of local loop technologies and services exchange carriers may provide, the factor would have to be

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[6] Moreover, to the extent that the Commission prescribes any new allocation factors, it should do so only with respect to new investment. Thus, any new cost allocation prescriptions would not govern <u>shifting</u> costs from regulated to unregulated accounts, but instead would merely govern how <u>newly incurred</u> investments will be allocated as between regulated and unregulated accounts.

allowed to vary by area and by company -- depending on relevant circumstances. This would reduce the sole advantage of this approach, simplicity.

A far more reasonable approach would be guidelines that would take into account such variables as the make-up of network plant (copper, coaxial cable, or hybrid fiber-coaxial systems), signal delivery (digital v. analog), and overall system capabilities (*i.e.*, one-way transmission or two-way interactive capability). If, in the interest of administrative simplicity, separate fixed factors can be justified (for example, for items too small to justify full analysis), they should not be developed and applied for individual services but for the cost category as a whole.

Given potentially immense consequences, the FCC should not reach a hasty conclusion -- especially in view of the reality that widespread integration of voice and video services over unified facilities is generally some time in the future. There is no need to rush to judgment on a matter of such complexity and long-term importance.

The Commission's Part 64 Rules and CC Docket No. 86-111 policies were enacted after accumulating an exhaustive public record over a period of several years. No such record now exists; selecting a fixed allocator based on the record of this accelerated proceeding wood mean far-reaching allocation methods that could have substantial impact on both interstate and intrastate revenue requirements and services would be imposed largely in the dark. Certainly, the Commission should proceed with deliberation and care in prescribing an allocation factor that could, if wrong, have devastating consequences. It would be far better to permit the companies and the regulators to accumulate some experience through the CAM process -- experience with particular analyses involving known facts applicable in a given company. Until then, the

Commission's existing Part 64 rules -- as overly burdensome as they are -- will furnish more than ample "protection" for the ratepayer interest.

B. Relative use allocators can be deployed for other types of network plant.

The difficulties in determining relative usage on local loop facilities does not extend to interoffice facilities. Interoffice facilities dedicated to a single service can be directly assigned. Then, for example, the number of individual fibers dedicated to a certain service can be used to determine a reasonable allocation factor. Under these circumstances, there is no need to consider establishing a fixed allocation factor, as the *Notice* (at paragraph 46) suggests, for interoffice network facilities.

Similarly, switching costs may continue to be allocated between regulated and nonregulated services based on relative usage. Although newer technologies, such as ATM switches, do not lend themselves to the use of standard measurement criteria (such as call duration), other methods can be used to allocate a portion of switching costs to nonregulated services supported by these technologies. Rather than being compelled to employ a "one size fits all" allocator, exchange carriers should be allowed to propose and document their allocation methodologies for switching facilities in their cost allocation manuals.

C. Expense and spare facility allocations can reasonably be tied to allocations of deployed plant.

Expense allocations proposed by the Commission are acceptable, if tied to reasonable methods of allocating plant. Spare facility allocations should generally follow the allocation of deployed plant, as they do today. While it is true that a portion of spare fiber capacity that exists today may be used in the future to support nonregulated services, there is no justification for immediately placing a substantial portion of such investment in nonregulated accounts. Growth in demand for regulated services does not disappear simply because a carrier elects to begin provision of a nonregulated offering. Moreover, extensive deployment of fiber optic technology will better enable LECs to provide advanced services to local community institutions, such as schools and libraries, as mandated by the 1996 Act. If the Commission adopts policies that intentionally over-allocate spare facility costs to nonregulated accounts, exchange carriers will be penalized for, and disincented from, upgrading their local telecommunications networks.

In summary: Rather than introducing arbitrary fixed factors, the Commission should simply adopt guidelines concerning allocation of regulated and nonregulated costs -- to be taken into account in the CAM process as each firm determines appropriate accounting treatment based on its own individual conditions.

Respectfully submitted,

GTE Service Corporation on behalf of GTE's domestic telephone and wireless service companies

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THEIR ATTORNEY

Attachment A

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This page has been substituted for one of the following:

o An oversize page or document (such as a map) which was too large to be scanned into the RIPS system.

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